PRIVY COUNCIL REPORT

HOCK HENG COMPANY SDN. BERHAD v. DIRECTOR-GENERAL OF INLAND REVENUE

[P.C. (Lord Diplock, Viscount Dilhorne, Lord Hailsham of Saint Marylebone, Lord Edmund-Davies and Lord Russell of Killowen) January 31, 1979]

[Privy Council Appeal No. 31 of 1976]

Revenue Law — Income Tax — Company carrying on business in Malaysia and Singapore — Whether company can set off losses in Singapore against Malaysian income — Income from "wherever derived" — Double Taxation Relief (Republic of Singapore) Order, 1966 — Income Tax Act, 1967, ss. 3 and 132.

This was an appeal from the decision of the Federal Court reported at [1976] 1 M.L.J. 276. The appellants had their head office in Kuala Lumpur and had also a permanent establishment in Singapore. For the year of assessment 1968, the appellants had an income of $31,415 from Malaysia but suffered a loss of $538,335 attributable to its business in Singapore. The question which arose was whether in computing the appellant's chargeable income from 1968, that loss is to be ignored or to be brought into account. The Special Commissioners of Income Tax held that it could be brought into account. The High Court and the Federal Court held that it could not.

Held, allowing the appeal (Lord Russell of Killowen dissenting): by virtue of paragraph 1 of Article XVII of the Double Taxation (Republic of Singapore) Order, 1966, the laws of Malaysia are to govern the taxation of income in Singapore except where provision to the contrary is made in the agreement. The agreement did not contain any provision requiring losses sustained in Singapore to be dealt with differently from the way they are dealt with under the Income Tax Act, 1967. In the computation of income from "wherever derived", losses which are deductible under that Act are deductible wherever they are sustained.

Case referred to:-

(1) *U.N. Finance Bhd.* v. *Director-General of Inland Revenue* [1975] 2 M.L.J. 224.

PRIVY COUNCIL APPEAL FROM MALAYSIA.

P. Nolan Q.C. (*S. Woodhull* with him) for the appellant.

P.W. Medd Q.C. (*N.F. Stadlen* and *Mokhtar bin Sidin* with him) for the respondent.

Cur. Adv. Vult

Viscount Dilhorne (delivering the majority judgment): Section 10(1) of the Income Tax Ordinance, 1947, of Malaya provided that income tax should be payable

"upon the income of any person accruing in or derived from the Federation or received in the Federation from outside the Federation. . . ."

and section 45 of that Ordinance, as amended in 1948, provided that:

"If the High Commissioner in Council by Order declares that arrangements specified in the Order have been made with the Government of any territory outside the Federation with a view to affording relief from double taxation in relation to tax under this Ordinance and any tax of a similar character imposed by the laws of that territory, and that it is expedient that those arrangements should have effect, the arrangements shall have effect in relation to tax under this Ordinance notwithstanding anything in any written law."

This provision was later amended to enable the Yang di-Pertuan Agong to exercise the powers it gave to the High Commissioner in Council, and in their exercise he made the Double Taxation Relief (Republic of Singapore) Order, 1966. Scheduled to that Order was an Agreement made between the Republic of Singapore and Malaysia and it is not disputed that the arrangements set out in that Agreement are to have effect notwithstanding any written law.

The Income Tax Ordinance, 1947, was repealed and replaced by the Income Tax Act, 1967, which by section 3 made a very considerable extension to the liability of a person resident in Malaysia to income tax. It provided that he should be chargeable to tax "upon his income from wherever derived".

The appellant, a company incorporated and resident in Malaysia, had in 1968 an income of $31,415 derived in Malaysia and had suffered a loss in that year of $538,335 on the operations of its branch in Singapore.

The question to be determined in this appeal is whether in computing the appellant's chargeable income for 1968, that loss is to be ignored or brought into account. The Special Commissioners of Income Tax held that it could be brought into account. The High Court and the Federal Court of Malaysia held that it could not.

It was common ground that, were it not for the arrangements scheduled to the Double Taxation Relief Order of 1966, the appellant would have been entitled to set off the losses incurred by its Singapore branch against its income for the purpose of determining its liability to Malaysian income tax. Is there anything in those arrangements which prevents that being done? If there is, that must override the 1967 Act.

Article IV of the arrangements scheduled to the Double Taxation Relief Order of 1966 provides *inter alia* as follows:

"1. (a) The profits of a Malaysian enterprise shall be taxable in Singapore unless the enterprise carries on business in Singapore through a permanent establishment situated in Singapore. If the enterprise carries on business as aforesaid, tax may be imposed in Singapore on the profits of the enterprise but only on so much of them as is attributable to that permanent establishment. No further tax shall be imposed in Malaysia in respect of profits of the permanent establishment which are remitted to Malaysia.

(b) [A similar provision with regard to a Singapore enterprise.]

2. Where an enterprise of one of the Contracting States carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions all expenses, including executive and general administrative expenses, which would be deductible if the permanent establishment were an independent enterprise in so far as they are reasonably allocable to the permanent establishment, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere."

The appellant company is a Malaysian enterprise and it carries on business in Singapore through a permanent establishment, so this article applies to it. If any profits are made by that establishment, they are taxable only in Singapore. They are not, whether or not remitted to Malaysia, taxable in Malaysia. To this extent the Double Taxation Relief Order qualifies

and overrides section 3 of the Income Tax Act, 1967. Its effect is that a person is chargeable to income tax under Malaysian law "upon his income from wherever derived" except income which has suffered tax in Singapore.

In computing the profits made in Singapore, expenses can be deducted, as one would expect. This article is concerned with profits and what is to happen to them. It does not purport to provide what is to happen if the Singapore branch makes no profit but a loss. Indeed in arrangements made with a view to affording relief from double taxation, it would be surprising if it did, and the Order does not contain any provision which does so.

The only other article to which it is necessary to refer is Article XVII which provides:

"1. The laws of each Contracting State shall continue to govern the taxation of income in that State except where express provision to the contrary is made in this Agreement. Where income is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article.

2. Where a resident of one Contracting State derives income from sources within the other Contracting State and that income in accordance with the income tax laws of each Contracting State and the provisions of this Agreement is subject to tax in the other Contracting State, the former Contracting State shall exempt such income from tax.

...."

Paragraph 2 of this article has no application to this case for paragraph 1 makes it clear that it only applies where income is subject to tax in both Contracting States and in 1968 the appellant company had no income subject to tax in Singapore.

Paragraph 1 of this article is, however, important and, in their Lordships' opinion, determinative of this appeal. The laws of Malaysia are to continue to govern the taxation of income in that State except where express provision to the contrary is made in the Agreement. Express provision is made for the exemption from tax in Malaysia of income which suffers tax in Singapore but the Agreement does not contain any provision requiring losses sustained in Singapore to be dealt with differently from the way they are dealt with under the Income Tax Act, 1967. In the computation of income from "wherever derived", losses which are deductible under that Act are deductible wherever they are sustained.

If it be the case that losses sustained in one year can be set off against profits of a subsequent year or years in Singapore and in Malaysia, it may be that the appellant company will by doing so reduce its income chargeable to tax in both Malaysia and Singapore. If that be the case, it does not, in their Lordships' view, enable a different interpretation to be given to the clear language of Article XVII. 1.

It was argued for the respondent that if profits from the Singapore branch were by virtue of Article IV not to suffer tax in Malaysia, it was implicit that losses from that source should also be ignored. While this may appear reasonable, the Agreement does not expressly so provide.

It follows that in their Lordships' opinion *U.N. Finance Bhd.* v. *Director-General of Inland Revenue*[1] was wrongly decided.

For these reasons their Lordships will advise His Majesty the Yang di-Pertuan Agong that the appeal should be allowed, the Orders of the Federal Court and the High Court set aside and the Deciding Order of the Special Commissioners of Income Tax restored. They will further advise that the respondent should pay the costs of this appeal and the costs in both courts below.

Lord Russell of Killowen (delivering his dissenting judgment): It is naturally with hesitation that I venture to disagree with the conclusion in this appeal of the other members of the Board, particularly when to them it appears to be a short and clear case for allowing the appeal.

Under the 1947 Income Tax Ordinance not only was it clear that profits from the Singapore establishment were not subject to assessment to the charge for Malaysian income tax, but it was also clear that losses from the Singapore establishment were not deductible in the computation for Malaysian tax purposes of the chargeable profits of the Malaysian establishment. See sections 10, 14 and 33(2). That is exactly what would be expected from a non-inclusion (or exemption) of profits from a stated source.

The 1966 Double Taxation Agreement Order in its application to the 1947 Income Tax Ordinance did not operate in this case save (by Article IV. 1(a)) to overrule the provision of section 10 of the 1947 Ordinance which subjected income of the Singapore establishment remitted to Malaysia to Malaysian income tax. It had no effect on the Malaysian law that profits of the Singapore establishment not remitted to Malaysia would not be subject to Malaysian income tax. It left the activities of the Singapore establishment as something wholly irrelevant to Malaysian tax.

Then followed the Income Tax Act, 1967, which first operated for the now relevant fiscal year 1968. That Act by section 3 subjected to Malaysian income tax the global activities of the appellant. The relevant terms of section 3 were:

"Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment —

(a) in the case of a person ordinarily resident for the basis year of assessment, upon his income from wherever derived; ..."

It is common ground that the effect of this would be to bring into charge for Malaysian tax income or profits of the Singapore establishment and require a set-off against in Malaysia profits of the taxpayer of losses of the Singapore establishment. Though the 1967 Act repealed the 1947 Ordinance it is common ground that Article XXI of the 1966 Double Taxation Agreement Order (under section 132 of the 1967 Act), albeit obscurely, had this effect: namely that the 1966 Double Taxation Agreement Order continued to operate for the fiscal year 1968 but in the legislative context of the 1967 Income Tax Act.

The problem in this appeal is therefore how to marry the 1966 Double Taxation Agreement Order

with the 1967 Income Tax Act, with the latter's global approach to the computation of profits for the purposes of the charge to Malaysian income tax. (As I understand the situation it was temporary, there having been since a reversion to the 1947 Ordinance approach to chargeable income.)

By section 45 of the 1947 Ordinance the 1966 Double Taxation Agreement Order was given legislative operation notwithstanding anything in any written law of Malaysia: that is accepted.

Article IV. 1(a) of the 1966 Order Agreement provided that the profits of the Singapore establishment might be taxed in Singapore, and that no further tax should be imposed upon such profits even when remitted to Malaysia. That made it clear that Malaysian tax was not to be imposed on profits of the Singapore establishment at all. Profits of the Singapore establishment were to be wholly irrelevant to Malaysian tax. Similarly in Article XVII. 2 it was provided that where a resident in Malaysia derives income from a source within Singapore, and that income is subject to tax in Singapore, Malaysia shall exempt such income from Malaysian income tax.

The views of the majority of their Lordships turn entirely upon the content of Article XVII. 1 of the 1966 Double Taxation Agreement.

"The laws of each Contracting State shall continue to govern the taxation of income in that State except where express provision to the contrary is made in this Agreement. Where income is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article."

It is said that this means that the global assessment of nett income under the 1967 Act continues to apply including the ability to set Singapore establishment losses against profits in Malaysia of the business, and that there is no *express* provision denying this. There is nothing express here except reference to income or profits from the Singapore establishment, and therefore nothing to deny the deduction (on the Malaysian global law approach) of losses at the Singapore establishment against the profits in Malaysia. The articles referred to relate only to profits of the Singapore establishment, and there were none: there were only losses. This is the crucial point, at which I respectfully part company with the majority of their Lordships.

I am not aware of any fiscal system of exemption from tax of a source of income which accepts losses from that source as a permissible deduction from other sources of income for the purpose of ascertaining nett taxable income. None was suggested to the Board. The 1947 Income Tax Ordinance, as explained, was to the contrary. Such a suggestion would seem to me to be quite contrary to any principle underlying fiscal systems of taxation of profits. If profits from a source of income are exempted from tax, of what concern to the taxing authority can be outgoings of that source, whether they do or do not exceed incomings? Their exclusion from consideration appears to me to be necessarily involved in the exemption from tax. Suppose that in section 3(a) of the Income Tax Act, 1967, after the words "income from wherever derived" there had occurred the words "except in the case of the Hock Heng Company income derived from its establishment in Singapore". I could not accept that in such case the appellant company could claim to offset losses at the Singapore establishment against its profits elsewhere by asserting that in the exception exemption there was no express statement that such losses could not be set off. A charging section, and an exemption provision, from their very nature are not appropriate to an express reference to losses. The effect of Articles IV and XVII cannot be different from the effect which in my opinion would necessarily be attributed to section 3 of the 1967 Act had it contained the words that I have suggested — viz.: that Singapore losses become necessarily as irrelevant to Malaysian taxation as are Singapore profits.

It is accepted by the majority of their Lordships that if their decision is correct the losses of the Singapore establishment can be carried forward not only against profits in Malaysia but also against future profits of the Singapore establishment. There is the further problem that if their Lordships' decision is correct there may be a situation in which according to Singapore tax law there is a profit there, but a loss according to Malaysian tax law. Both strange results.

I conclude, therefore, that the inability to set off losses in the Singapore establishment, being necessarily dependent upon the express prohibition to charge its profits to Malaysian tax, is the subject of an express provision contrary to the Malaysian 1967 Income Tax Act. I would for myself dismiss the appeal.

Appeal allowed.

Solicitors: *Slaughter & May; Stephenson Harwood.*

PRIVY COUNCIL APPEAL

LEE KOK KENG v. PUBLIC PROSECUTOR

[Federal Court Criminal Appeal No. 8 of 1975]

The petition by the appellant abovenamed for special leave to appeal *in forma pauperis* to His Majesty the Yang di-Pertuan Agong in the above Appeal ([1976] 1 M.L.J. 125) has been dismissed by the Privy Council on October 26, 1978.